No. 993

In the Supreme Court of the United States

OCTOBER TERM, 1943

OTIS & CO., PETITIONER

v.

SECURITIES AND EXCHANGE COMMISSION AND THE UNITED LIGHT AND POWER COMPANY

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

MEMORANDUM FOR THE SECURITIES AND EXCHANGE COMMISSION

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The respondent Securities and Exchange Commission, does not oppose the petition of Otis & Co. that a writ of certiorari be issued to review the judgment of the United States Circuit Court of Appeals for the Third Circuit, entered April 20, 1944.

OPINIONS BELOW

The findings and opinion of the Securities and Exchange Commission (R. 3, 87), not yet officially reported, are set forth in the Commission's Holding Company Act Release No. 4215. The opinion

of the United States District Court for the District of Delaware (R. 94) is reported in 51 F. Supp. 217. The opinion of the United States Circuit Court of Appeals for the Third Circuit (R. 144) is not yet reported.

JURISDICTION

The judgment of the United States Circuit Court of Appeals for the Third Circuit was entered April 20, 1944 (R. 164). The petition for a writ of certiorari was filed May 11, 1944. The jurisdiction of this Court is invoked under Section 240 of the Judicial Code as amended by the Act of February 13, 1925, the provisions of which are made applicable by Section 25 of the Public Utility Holding Company Act of 1935 (the "Act"; 49 Stat. 803, 15 U. S. C. § 79a *et seq.*).

QUESTION PRESENTED

Pursuant to an order of the Securities and Exchange Commission under Section 11 (b) (2) of the Act, requiring The United Light and Power Company ("Power") to liquidate and dissolve (R. 139), Power took steps to satisfy the claims of all creditors. Thereafter, Power presented to the Commission for approval as "fair and equitable" under Section 11 (e) of the Act a plan allocating among Power's preferred and common stockholders the common stock of its subsidiary holding company to which will be transferred all of Power's remaining assets.

Although the present value of Power's assets is conceded to be less than the charter liquidation preference of Power's preferred stock, including arrears, the Commission found that the prospects for future earnings are such that, absent the corporate simplification requirements of the Act and assuming that Power should continue with its existing security structure, the arrears of dividends could be discharged, affording an ultimate prospect for resumption of dividends on the common stock. The Commission concluded that an allocation of the common stock of the subsidiary on the basis of 95% to the preferred and 5% to the common stock of Power approximately reflects their relative interests in the existing security structure (R. 20–32).

The question presented is whether in applying to such a plan the "fair and equitable" standard prescribed in Section 11 (e) the Commission erred in determining the proper allocation of securities upon the basis of the entire bundle of rights of both classes of Power's stock, with primary reference to their relative expectations of participating in income under the existing structure, rather than exclusively upon the basis of the charter liquidation preference of Power's preferred stock.[1]

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[1] The question is solely whether the common stockholders of Power are entitled to any participation in the new securities. No question is raised as to the particular amount of participation approved by the Commission.

STATUTE INVOLVED

The applicable provisions of the Act are set forth in the Appendix, *infra*, pp. 26–29. The substance of the relevant statutory provisions is as follows:

Under Section 11 (b) (2) of the Act, it is the duty of the Commission to require all registered holding companies and their subsidiaries to "take such steps as the Commission shall find necessary" to simplify the structures of their holding company systems and to correct the distribution of voting power. One specific instance of undue complications the correction of which is mandatory is the situation where there are more than two tiers of holding companies in violation of the "great grandfather" provision.

To enable the Commission to *compel* compliance with its orders issued under Section 11 (b) (2), the Commission is authorized by Section 11 (d) of the Act to resort to the district courts for enforcement thereof; and the courts are empowered, *inter alia*, to dispose of the corporate assets "in accordance with a fair and equitable reorganization plan which shall have been approved by the Commission after opportunity for hearing."

To enable companies subject to Section 11 (b) (2) to effect *voluntary* compliance with the requirements of that section, Section 11 (e) of the Act permits companies to "submit a plan to the

Commission for the divestment of control, securities, or other assets, or for such other action" as will enable the companies to comply. The Commission, after notice and opportunity for hearing, is authorized to consider whether the plan is "necessary to effectuate the provisions of subsection (b)[2] *and fair and equitable to the persons affected by such plan,*" and if the Commission so finds, to make an order approving the plan. Thereafter, the Commission is empowered, at the request of the company, to apply to a district court "to enforce and carry out the terms and provisions of such plan." The court, after notice and opportunity for hearing, is authorized to "approve such plan as *fair and equitable* and as appropriate to effectuate the provisions of section 11"[3] and is vested with jurisdiction to enforce the plan so approved.

STATEMENT

(a) *Proceedings below.*—Pursuant to Section 11 (e) of the Act, the Commission, at the request of Power, applied to the United States District Court for the District of Delaware to enforce a plan which, as modified (R. 112) the Commission had approved after a hearing (R. 3, 87, 89). The district court, after notice and hearing (R.

[2] No question was raised in the present case as to the findings that the plan was necessary and was appropriate to effectuate the provisions of Section 11.

[3] See footnote 2. [Italics supplied.]

141), approved the plan by judgment entered August 4, 1943 (R. 109). On appeal by Otis & Co., a preferred stockholder and an intervenor in the district court, the circuit court of appeals unanimously affirmed the judgment of the district court (R. 144, 164).

(b) *The Factual Basis of the Commission's Order.* Power, a registered holding company at the top of a system which embraced 52 companies, including 7 registered holding companies, was found by the Commission to violate the requirements of Section 11 (b) (2), and particularly the "great grandfather" provision (R. 129–130). On March 20, 1941, the Commission ordered Power to proceed with due diligence to liquidate and dissolve (R. 139). The decision to liquidate Power rather than to pursue alternative avenues to the simplification of the system was based on considerations of economy and convenience apparently dictated by the best interest of all classes of Power's security holders (R. 10–17). No proceedings to review that order were ever taken. Thereafter the Commission approved various applications by Power to carry out steps necessary to the required liquidation.

As the final step in the liquidation program, Power submitted to the Commission a plan (Application No. 14) to retire its remaining debt, to transfer miscellaneous assets as a capital con-

tribution to its chief subsidiary holding company, United Light and Railways Company ("Railways"), and to distribute Power's remaining asset, the common stock of Railways, to Power's preferred and common stockholders, by allocating 91.2% thereof to Power's preferred stockholders and 8.8% to its common stockholders (R. 4–9).

Evidence was taken upon the plan. The basic problem before the Commission was how to distribute the common stock of Railways fairly and equitably between Power's two classes of stockholders. One factor considered by the Commission was that the preferred had a preferential right by charter to receive $100 per share plus $64.50 accumulated dividends (as of December 31, 1942) on "voluntary or involuntary" dissolution or liquidation, or an aggregate of $98,700,000, including dividend arrearages, on the outstanding 600,000 shares, before any payment might be made to the common (R. 11). All members of the Commission concluded that the value of Railways' common stock was less than the liquidation preference of the preferred, and, if the sole basis of allocation were the charter liquidation preference, then Power's common stockholders could take nothing (R. 11–13, 53).

The factual analysis used by the majority of the Commission went beyond this point, however. The majority considered the past earnings of Power and Railways, on both corporate and con-

solidated bases with adjustments for certain nonrecurring items, in order to arrive at an estimate of the future earning power of Railways' common stock. Power's corporate income since 1932 had been less than the annual preferred dividend requirement of $3,600,000, but the consolidated net income had fluctuated widely, and over the period of 1932–41 had produced a net balance in excess of the current requirements of Power's preferred stock of over $18,000,000. The bulk of the consolidated earnings had not, however, been taken up into Railways or Power, and no dividends had been paid on Power's preferred or common stocks since 1932. Consolidated earnings applicable to the common stock of Railways for the period 1937–41, subject to adjustments for certain nonrecurring expenditures, averaged in excess of $6,000,000 per annum, and for the period 1937–42 had exceeded $6,184,000 as an annual average. (R. 19–32.)

From the foregoing and the management's testimony as to estimated future earnings, the majority of the Commission concluded that future annual earnings of $6,185,000 might be attributed to Railways' common stock, for the purpose of determining the existing rights of Power's preferred and common stocks in the enterprise (R. 30). This figure was considered, however, to be a "very liberal assumption" and was to be discounted accordingly (R. 30–31). On this basis, and assuming that all consolidated net earn-

ings might be applied to the payment of current and accumulated preferred dividends (again, an assumption which the Commission discounted as overliberal), it would take approximately 15 years to pay off Power's preferred dividend arrearages (R. 30).

The majority of the Commission emphasized the remote character of the common stockholders' interest and for that reason disapproved the company's proposal to allocate approximately 9% of the common stock of Railways to the common stockholders of Power (R. 30–31). Nevertheless it was concluded that, absent liquidation or reorganization to comply with Section 11, there was a reasonable possibility that, on the basis of its existing capital structure, Power would ultimately pay off the preferred dividend arrearages and place the common stock on a dividend-paying footing. This possibility was deemed sufficiently substantial to justify a lesser allocation to the common stock than had been proposed. With respect to the size of the allocation, the majority considered the question as "of necessity one of over-all judgment and not susceptible of mathematical demonstration," and held that a participation of approximately 5%, "while representing the maximum, would not exceed the permissible limits of fairness." (R. 31–32.)

Thus, in effect, the Commission was considering Power's situation as it might exist, absent reor-

ganization, some 15 years hence, after the preferred dividend arrearages should be paid. At that time the preferred would be limited to an annual dividend of $3,600,000, and 100% of all the additional earnings would be applicable to the common. Under the Commission's suggestion of a 5% participation for the common stock of Power, the common stockholders would surrender their 100% future interest in the estimated $2,585,000 of excess annual earnings to begin at that time, in exchange for a 5% interest in the entire estimated annual earnings of $6,185,000 (or $309,250) beginning at once. In return, the preferred stockholders would surrender approximately 5% of their exclusive interest in all earnings during the 15-year period and in the first $3,600,000 of income thereafter, in exchange for a new right in perpetuity to 95% of the estimated excess annual earnings beginning at the expiration of the 15 years.[1]

The difference between what the common stockholders would surrender after elimination of

[1] This analysis concededly involves some over-simplification. We are speaking of estimated consolidated earnings which would not as a practical matter be entirely distributed in dividends. To the extent that such earnings would be retained in the business, the amount immediately payable would necessarily be reduced, thereby delaying progress in discharging the dividend arrears. How much these factors would ultimately affect the amount available for the common stock after the dividend arrears should be paid and the time required to pay off arrears would depend upon the amount of additional income received from the earnings retained.

arrears and what they would receive under the Commission's suggested allocation (a ratio of about 8.4 to 1) indicates how the Commission appraised the advantage to the common stock of the elimination of the 15-year delay, the $3,600,000 annual preference of the preferred stock, and the risk that distributable earnings might prove less than the estimate. But for the inherent risk factor, the difference between the future interests which would be surrendered and the new interests presently to be received by the common stockholders is comparable to the difference between an annuity of $8.40 commencing 15 years hence and an annuity of $1 beginning immediately. To make these annuities mathematically equivalent, the larger would have to be discounted to present value at the rate of 15.2%. This very high discount rate measures the risk factor involved in the assumption by the majority of the Commission that Power's common stock had a reasonable prospect of receiving an estimated $2,585,000 annually beginning 15 years in the future, and offsets the "very liberal" character of the estimate of consolidated earnings.[5] Accordingly, the majority held that the allocation of 5% to Power's common stock was a fair alloca-

[5] The majority of the Commission pointed out that in a pyramided holding company system earnings are subject to wide fluctuations, and an increase of only a few percent in operating company earnings would be magnified into a very

tion taking account of the considerations involved. Commissioner Healy's dissenting opinion (R. 46) sharply disagreed with this conclusion.[6]

The plan was modified to allocate 94.52% of Railways' common stock to Power's preferred stockholders and 5.48% thereof to its common

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great improvement at the holding company level. The majority recognized a possibility, therefore, that future earnings might actually exceed even the "very liberal" estimates (R. 31).

Under Power's original plan of allotting 8.8% to the common stock, the common would have been given a present annuity of $544,280 in lieu of the future annuity of $2,585,000. This would have indicated a discount rate of 11%, a ratio which justifies the conclusion implicit in the Commission's rejection of Power's original plan that the common was being allotted too much in view of the risks involved.

[6] The principal factual points urged by Commissioner Healy against the use by the majority of the Commission of the $6,185,000 future earnings figure are:

(a) It is an estimate of consolidated earnings and not of corporate earnings of Railways available for its common stock. In prior years the corporate earnings have been substantially less than consolidated earnings.

However, the past record of corporate earnings is not necessarily the significant index for the future. Completion of the statutory simplification program will remove dividend blocks which have prevented the passing up of dividends of Railways' subsidiaries in the past and will restore managerial incentive so to do. Furthermore, any dividends not paid up will, as invested funds, produce earnings, and thereby ultimately increase system earnings.

(b) The adjustment of past earnings for nonrecurrent items is based upon too-liberal assumptions.

While this may be true, the liberality is compensated by the high discount rate implicitly used.

stockholders[7] (R. 112). With this modification the plan was approved by the Commission as fair and equitable (R. 87, 89).

DISCUSSION

(a) *The Legal Basis of the Commission's Order.*

(1) Although the "fair and equitable" standard embodied in Section 11 (e) is verbally the same as those "words of art" which this Court held in *Case* v. *Los Angeles Lumber Products Co., Ltd.*, 308 U. S. 106, require application of the "absolute priority" doctrine developed in equity receiverships and reorganizations under former Section 77B of the Bankruptcy Act, the majority of the Commission concluded in the present case (R. 14–19) that the precedents for determining the participation of claims of creditors and others in such proceedings are not wholly applicable in dealing with a readjustment of rights of stockholders of a solvent company under Section 11 (e) of the Holding Company Act, because such precedents (R. 14):

> are predicated on sets of facts fundamentally distinguishable from the situation arising here. In bankruptcy or equity reorganizations * * * creditors and other claimants are prevented from foreclosing or otherwise compelling an actual

[7] The fractions resulted from an allocation of 5 shares of Railways' common for each share of Power's preferred and 1 share of Railways' common for each 20 shares of Power's common.

> liquidation, but new securities are distributed among them according to their contractual and other rights determined as though in liquidation. * * *
>
> On the other hand, Power is a company virtually without debt and under no financial embarrassment in the traditional bankruptcy or equity sense.

The majority of the Commission considered that this view was not a departure from the "absolute priority" doctrine which, it understood, requires full compensation for rights surrendered. *Group of Institutional Investors* v. *Chicago, M., St. P. & P. R. Co.*, 318 U. S. 523, 565–66. Rather, the majority considered that the preferred stockholders of Power were receiving full compensation for what the majority deemed to be their "rights" in the context of this proceeding under the Act, and therefore were being accorded their "absolute priority." The only question was what are the "rights" for which the preferred stockholders are entitled to compensation. Thus, it was observed that the right surrendered in the bankruptcy reorganization is a claim, which has matured in accordance with the expectation of the parties, to the face amount of a debt security or to the liquidation preference of a senior stock. In contrast, the Commission is frequently required under Section 11 of the Holding Company Act to deal with unmatured claims, and here with an inchoate liquidation preference which,

apart from the statute, preferred stockholders had no right to mature (R. 14–18).[8]

The majority of the Commission interpreted the "fair and equitable" standard of Section 11 in the light of the entire Act, and its legislative history,[9] as intended to afford recognition, in the simpler security structures envisaged by the Act, to each class of security holders which has an interest in the existing structures—and not as intended to afford any class a windfall at the

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[8] Petitioner urges that there is no real distinction between reorganizations under the Act and bankruptcy reorganizations, and particularly that *Case* v. *Los Angeles Lumber Products Co., Ltd.*, 308 U. S. 106, dealt with the rights of stockholders *vis-a-vis* holders of income bonds which had not matured prior to the institution of the proceedings. However, the company had filed a voluntary petition under Section 77B and had admitted therein its insolvency, thereby invoking the ordinary bankruptcy principle which permits proof of claims whether matured or unmatured. The particular language from this Court's opinion quoted at page 18 of petitioner's brief must be read in its context as indicating only that a company filing a voluntary petition under Section 77B, and admitting its insolvency, cannot exact a price for that admission so as to entitle stockholders to a participation which would not have been warranted had creditors succeeded in instituting an involuntary proceeding. That decision has no relevance to the question whether the reorganization provisions of the present Act should be construed as intended to mature otherwise unmatured and inchoate liquidation preferences.

[9] Reference to this legislative background is cited in the Commission's opinion (R. 16–17) and additional materials appear in the opinion of the court below (R. 157–158). One of the documents referred to, namely Congressman Eicher's "additional views" appended to the House Report to accompany S. 2796, specifically emphasizes the distinction

expense of another. This conception does not permit holders of worthless common stock to capitalize on mere nuisance positions,[10] or permit the exaction of a toll for the surrender of inequitable voting rights proscribed by the statute.[11] On the other hand, it does not permit the preferred stockholders to treat their otherwise in-

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between the preservation of stockholders' equities and the maturing of liquidation rights:

"Long ago, under the Sherman Antitrust Law and under the commodities clause of the Hepburn Act, the courts worked out a technique which would permit readjustments and reorganizations, *without the acceleration of indebtedness or the maturing of rights upon liquidation*, to enable corporations to rearrange their corporate structures and divest themselves of properties to the extent required to comply with Government policy. The courts have even gone so far as to permit the equitable apportionment among several properties of a general mortgage lien theretofore attaching to those properties as an indivisible whole, without accelerating the maturity date of the mortgage, if the segregation of those properties is necessary to conform to the policy of the Federal statutory law (*Continental Insurance Co.* v. *U. S., Reading Co., et al.*, 259 U. S. 156). The allegation that the Senate bill will cut off valuable equities by the forced liquidation of assets and the dumping of securities upon a demoralized market are consequently not borne out by the provisions of the Senate bill or the judicial precedents established in analogous cases." H. Rept. No. 1318, 74th Cong., 1st Sess., pp. 49–50. [Italics supplied.]

[10] In *Federal Water Service Corp.*, 8 S. E. C. 893, 914 (1941) and *Southern Colorado Power Co.*, Holding Company Act Release No. 4501 (1943) the Commission excluded from participation common stocks having no reasonable prospect of ever receiving anything from the corporation.

[11] *Columbia Gas & Electric Corp.*, Holding Company Act Release No. 3885 (1942), affirmed on review, *sub nom. Marquis & Co.* v. *S. E. C.*, 134 F. (2d) 882 (C. C. A. 3, 1943).

choate claim to a liquidation preference (including dividend arrears) as a matured claim on the basis of which they may wipe out common stockholders if the present value of the assets happens to be less than the amount of that claim.

Since the Commission, on the basis of the analysis discussed *supra*, pp. 6–13, found (a) that, under the existing securities structure, there was a reasonable prospect of Power's ultimately receiving sufficient income to pay current and accrued dividends on the preferred and to resume payments on its common stock, and (b) that approximately 5% of the common stock of Railways distributable under the plan was the fair equivalent of that expectation, it arrived at the 95–5% allocation embodied in the plan.

(2) The circumstance that the statutory readjustment in this case took the form of a liquidation of Power as a separate corporate entity was considered by the majority not to be determinative (R. 13–17). Once having concluded that it is the purpose of the statute to preserve through "fair and equitable" plans equities of the type represented by Power's common stock, the Commission could not treat the order prescribing a particular form of reorganization as reducing the substantive rights of Power's common stockholders *vis-a-vis* the preferred by maturing the otherwise inchoate liquidation preference of the preferred. The liquidation of Power as a sep-

arate corporate entity was treated as a procedural mechanism for the reorganization and not as necessitating a different substantive result from that which would be fair and equitable in a recapitalization or merger. The choice of this particular procedure had been dictated upon purely practical grounds. It would have been possible, though less practical, to employ other mechanics including the merger or consolidation of Power and Railways, or a one-stock reorganization of Power, followed by dissolution. The choice of the most economical and expeditious method was in the interest of preferred stockholders and common stockholders alike, as well as in accordance with the mandate of Section 11 (b) that the Commission proceed "as soon as practicable." Under such circumstances, to permit the formal device chosen for the reorganization to determine substantive results would be bad public policy and bad law.

Granted that it was fair and equitable to utilize the liquidation of Power as a reorganization device without treating the charter liquidation preference as controlling, it is clear that this contract right was not beyond the reach of Congress under the commerce power. Thus, in *Continental Insurance Co.* v. *United States*, 259 U. S. 156, cited in the legislative history quoted *supra*, p. 16, n. 9, this Court said (p. 171) that "the power of the court under the Sherman Anti-Trust Law to disregard the letter and legal effect

of the bonds and general mortgage under the circumstances of this case, in order to achieve the purpose of the law, we cannot question." See also *Philadelphia, B. & W. R. Co.* v. *Schubert*, 224 U. S. 603.

The majority of the Commission concluded further that the refusal to give effect to the charter liquidation preference under the unique circumstances of the case would not disappoint any reasonable expectation of the preferred stockholders. As the Commission and the courts below pointed out (R. 13, 102–103, 156–157), the contingency which allegedly has matured the liquidation preference is one which could not have been anticipated by the parties when the stock was issued in 1929, before enactment of the Act. *Cf. Chicago, Milwaukee & St. Paul Ry. Co.* v. *Hoyt*, 149 U. S. 1, 15.

Finally, it was clear that the liquidation which the Commission had ordered was not the kind of dissolution of a business enterprise that would properly invoke the contractual liquidation preference of Power's preferred stock. As the opinion of the majority of the Commission discloses, the preferred and common stockholders of Power have been the residual co-owners of a vast public utility system controlled through Power, the top holding company, and Railways, its principal subholding company subsidiary. This they will continue to be, for the principal result accomplished by the Commission's order is to break off

one of the corporate shells through which their residual ownership was held, and to transform their interests into stock of the next corporate entity, Railways. In essence, therefore, while Power is being dissolved, the enterprise is not.

(b) *Importance of the Question in the Administration of the Act.*

While petitioner contends that the Commission's interpretation of the "fair and equitable" standard in this case conflicts with the "absolute priority" doctrine announced by this Court—and with this Court's decisions under the reorganization provisions of the Bankruptcy Act—it is the Commission's view that no such conflict exists. This case is, however, of substantial public importance because it is the first to be presented to this Court of a series of cases in which the Commission has applied the "fair and equitable" standard in determining the respective participations of preferred and common stockholders of a solvent company under a plan to effectuate the corporate simplification provisions of Section 11 (b) (2) of the Act.

In each of these cases the determination has been made after an evaluation of the entire bundle of rights of the old classes, but with primary reference to their expectations of participating in future income under the existing financial structure. This view has been maintained whether the

plan involved a merger[12] or a recapitalization.[13] The common denominator in all the plans involved in these cases has been a provision for continuation of the enterprise either by the same or by a new corporation, but with a single class of stock substituted for two or more preceding classes. Specifically, the Commission has held that where a class of junior stock has a reasonable expectation of participating in future income under the existing security structure, it must receive the equitable equivalent of this interest in the form of securities distributable under a plan, notwithstanding the fact that the present value of the company's assets may be less than the stipulated

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[12] *Federal Water Service Corp.*, 8 S. E. C. 893 (1941), remanded on another point, *S. E. C.* v. *Chenery Corp.*, 318 U. S. 80; *International Utilities Corp.*, Holding Company Act Releases Nos. 4896, 4992 (1944), enforcement proceedings pending in United States District Court for the Northern District of New York.

[13] *Community Power and Light Co.*, 6 S. E. C. 182 (1939), plan enforced, 33 F. Supp. 901 (S. D. N. Y., 1940); *Puget Sound Power & Light Co.*, Holding Company Act Release No. 4255 (1943); *Southern Colorado Power Co.*, Holding Company Act Release No. 4501 (1943); *Virginia Public Service Co.*, Holding Company Act Release No. 4618 (1943). The Commission's orders in the *Puget Sound* and *Southern Colorado* cases have been enforced (without opinion) in the United States District Courts for Massachusetts and Colorado, respectively. An appeal is pending in the *Southern Colorado* case.

Mimeographed copies of the Commission opinions not yet reported are being filed with the Clerk.

liquidation preference of the preferred stock. Such a participation allowed for the common stock has, of course, resulted in according the preferred stock less than 100% interest in the corporation. In each of these cases, as in this case, Commissioner Healy has dissented, and petitioner relies on a number of these dissenting opinions. Petitioner's theory as to the proper standard applicable in all types of such reorganization is that preferred stockholders cannot be fully compensated by receipt of less than 100% of the new securities unless the present value of the assets exceeds the liquidation preference of the preferred stock, including arrears of cumulative dividends. A necessary consequence of that view is that where the assets are found to be less than the liquidation preference, the common stock must be wiped out, notwithstanding a finding that there is a reasonable prospect of common stockholders participating in future income under the existing security structure."

" In addition to his disagreement on the law, Commissioner Healy also disagreed, in this and in previous cases, with the majority's finding that the junior stock in question would have had a reasonable expectation of participating in future dividends in the absence of a reorganization. The Commission opinions referred to are set forth *supra*, footnotes 12 and 13. In the first case involving this problem, *Community Power and Light Co.*, 6 S. E. C. 182 (1939), Commissioner Healy concurred in the result without opinion. The Commission's order in that case was enforced in the District Court for the Southern District of New York.

In the present case the preferred and common stockholders of Power were allocated new securities which the Commission found to be the equitable equivalent of their existing interests in the same enterprise. Nevertheless, since the readjustment took the form of a "liquidation" of the corporate entity in which they held stock, this novel feature of the case is used to buttress petitioner's argument. However, the petition for certiorari, like petitioner's argument in the court below, goes beyond this aspect of the case and challenges the Commission's interpretation of the standard in all types of corporate simplification plans. The position of the majority of the Commission, approved by the courts below, is that the formal mechanics by which a Section 11 corporate readjustment is accomplished should not affect the substantive interpretation to be given to the "fair and equitable" standard.

Although the decision of the circuit court of appeals was correct, we submit, and is in accord with the uniform holdings of all courts which have considered the question,[15] we believe that there is a

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Community Power and Light Co., 33 F. Supp. 901 (S. D. N. Y. 1940). Commissioner Healy did not participate in *International Utilities Corp.*, Holding Company Act Releases Nos. 4896, 4992 (1944).

[15] *Community Power and Light Co.*, 33 F. Supp. 901 (S. D. N. Y. 1940); *Puget Sound Power & Light Co.*, D. Mass. June 10, 1943 (no opinion); *Southern Colorado Power Co.*, D. Colo. Jan. 19, 1944 (no opinion; appeal pending in C. C. A. 10).

public interest in a determination by this Court which would lay at rest any questions which may remain as to the correctness of the result. The issue is presented in more than twenty proceedings before the Commission and is likely to arise in numerous other proceedings necessary to the administration of the Act. In addition, the issue is pending in one case now on appeal in a circuit court of appeals.[16]

CONCLUSION

The foregoing exposition of the factual and legal basis of the Commission's decision in this case demonstrates, we believe, the correctness of that decision and of the affirmance thereof by the courts below. We understand that the company will oppose certiorari because of its desire to go forward with the consummation of its plan.

In unsupervised voluntary reorganizations which occasionally reach the courts under attack for such gross unfairness as amounts to constructive fraud (*Hottenstein* v. *York Ice Machinery Corp.*, 136 F. (2d) 944 (C. C A 3, 1943)), the common stock ordinarily demands and receives a much larger participation than has been permitted in the Commission's cases. Commentators have approved the Commission's trend of decision as reaching a more equitable result than is customarily reached in the unsupervised cases. See: Dodd, *The Relative Rights of Preferred and Common Shareholders in Recapitalization Plans under the Holding Company Act* (1944), 57 Harv. L. Rev. 295; Dodd, *Fair and Equitable Recapitalizations* (1942), 55 Harv. L. Rev. 780; Latty, *Fairness—The Focal Point in Preferred Stock Arrearage Elimination* (1942), 29 Va. L. Rev. 1.

[16] See *Southern Colorado Power Co.* case, *supra*, note 15.

We should regret the delay that further review would cause to the carrying out of the company's program. Nevertheless, we believe that the importance of the question presented in the administration of the Act warrants review by this Court.

Respectfully submitted.

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MAY 1944.

APPENDIX

The pertinent provisions of the Public Utility Holding Company Act of 1935, c. 687, 49 Stat. 803 (15 U. S. C. §§ 79, *et seq.*), are as follows:

SECTION 11 (b) (2):

> (b) It shall be the duty of the Commission, as soon as practicable after January 1, 1938:
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> * * * * *
>
> (2) To require by order, after notice and opportunity for hearing, that each registered holding company, and each subsidiary company thereof, shall take such steps as the Commission shall find necessary to ensure that the corporate structure or continued existence of any company in the holding-company system does not unduly or unnecessarily complicate the structure, or unfairly or inequitably distribute voting power among security holders, of such holding-company system. In carrying out the provisions of this paragraph the Commission shall require each registered holding company (and any company in the same holding-company system with such holding company) to take such action as the Commission shall find necessary in order that such holding company shall cease to be a holding company with respect to each of its subsidiary companies which itself has a subsidiary company which is a holding company. Except for the pur-

pose of fairly and equitably distributing voting power among the security holders of such company, nothing in this paragraph shall authorize the Commission to require any change in the corporate structure or existence of any company which is not a holding company, or of any company whose principal business is that of a public-utility company.

* * * * *

SECTION 11 (d):

(d) The Commission may apply to a court, in accordance with the provisions of subsection (f) of section 18, to enforce compliance with any order issued under subsection (b). In any such proceeding, the court as a court of equity may, to such extent as it deems necessary for purposes of enforcement of such order, take exclusive jurisdiction and possession of the company or companies and the assets thereof, wherever located; and the court shall have jurisdiction, in any such proceeding, to appoint a trustee, and the court may constitute and appoint the Commission as sole trustee, to hold or administer under the direction of the court the assets so possessed. In any proceeding for the enforcement of an order of the Commission issued under subsection (b), the trustee with the approval of the court shall have power to dispose of any or all of such assets and, subject to such terms and conditions as the court may prescribe, may make such disposition in accordance with a fair and equitable reorganization plan which shall have been approved by the Commission after opportunity for hearing. Such reorganization plan may be proposed in the

first instance by the Commission, or, subject to such rules and regulations as the Commission may deem necessary or appropriate in the public interest or for the protection of investors, by any person having a bona fide interest (as defined by the rules and regulations of the Commission) in the reorganization.

SECTION 11 (e):

(e) In accordance with such rules and regulations or order as the Commission may deem necessary or appropriate in the public interest or for the protection of investors or consumers, any registered holding company or any subsidiary company of a registered holding company may, at any time after January 1, 1936, submit a plan to the Commission for the divestment of control, securities, or other assets, or for other action by such company or any subsidiary company thereof for the purpose of enabling such company or any subsidiary company thereof to comply with the provisions of subsection (b). If, after notice and opportunity for hearing, the Commission shall find such plan, as submitted or as modified, necessary to effectuate the provisions of subsection (b) and fair and equitable to the persons affected by such plan, the Commission shall make an order approving such plan; and the Commission, at the request of the company, may apply to a court, in accordance with the provisions of subsection (f) of section 18, to enforce and carry out the terms and provisions of such plan. If, upon any such application, the court, after notice and opportunity for hearing, shall approve such plan as fair and equitable and as appro-

priate to effectuate the provisions of section 11, the court as a court of equity may, to such extent as it deems necessary for the purpose of carrying out the terms and provisions of such plan, take exclusive jurisdiction and possession of the company or companies and the assets thereof, wherever located; and the court shall have jurisdiction to appoint a trustee, and the court may constitute and appoint the Commission as sole trustee, to hold or administer, under the direction of the court and in accordance with the plan theretofore approved by the court and the Commission, the assets so possessed.

U. S. GOVERNMENT PRINTING OFFICE: 1944